SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1924.

No. 80

THE UNITED STATES OF AMERICA, PETITIONER

vs.

EDWARD H. CHILDS, TRUSTEE IN BANKRUPTCY OF J. MENIST COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

INDEX

United States District Court, Southern District of New York

In the matter of
J. MENIST CO., INC., Bankrupt — In bankruptcy No. 27602

Order to show cause

Upon reading and filing the annexed petition of Edwards H. Childs, duly verified, and upon all the pleadings and proceedings herein it is

ORDERED, That the collector of internal revenue for the second district of New York show cause before me at my office, No. 299 Broadway, borough of Manhattan, city of New York, on the 27th day of July, 1922, at 1.15 o'clock in the afternoon, or as soon thereafter as counsel can be heard, why an order should not be granted herein directing that the proof of claim filed by the collector of internal revenue in the sum of $2,421.75 with interest at the rate of 1% per month from the 1st day of March, 1920, until paid, be liquidated and reduced to the sum of $2,421.75.

2 Let service of a copy of the annexed petition and order to show cause upon the collector of internal revenue, second district of New York, on or before the 20th day of July, 1922, be sufficient.

Dated, New York, June 29th, 1922.

J. J. TOWNSEND,
Referee in Bankruptcy.

United States District Court

[Title omitted.]

Petition

To Hon. JOHN J. TOWNSEND,
Referee in Bankruptcy.

The petition of Edwards H. Childs, respectfully shows:

1. Your petitioner is the trustee herein, duly qualified and acting.

2. A proof of claim has been duly filed by the collector of internal revenue in the sum of $2,421.75, additional income tax

3 due for the year 1917 and interest at the rate of 1% per month from the 1st day of March, 1920, until the date of payment.

3. Your petitioner believes that the said collector of internal revenue is not entitled to any interest upon said indebtedness and therefore asks for an order to show cause why the proof of claim filed by the collector of internal revenue should not be liquidated and reduced to the sum of $2,421.75.

Dated, New York, June 28, 1922.

EDWARDS H. CHILDS, *Petitioner.*

[Jurat showing the foregoing was duly sworn to by Edwards H. Childs. Omitted in printing.]

4 In United States District Court

[Title omitted.]

Proof of claim

At the customhouse, in said district on the 4th day of May, A. D. 1921, came William H. Edwards as collector of internal revenue for the second district of New York, in the county of New York, in the district aforesaid, and made oath and says that the persons by (or against) whom petition for adjudication of bankruptcy has been filed was at and before the filing of said petition and still is justly and truly indebted to said deponent in the sum of $2,421.75 dollars with 5% penalty and 1% interest per month thereon until paid; that the consideration of said debt is additional income tax for year 1917 (list Sept., 1919, fol. 18, line 6), due the United States Government; that preference is claimed on the ground that claim herein is due the United States Government; that no part of said debt has been paid; that there are no set-offs or counterclaims to the same; and that neither the deponent nor his successors, nor has any person by his order, or to his knowledge or belief, for his use, had or received any manner of security for said debt whatever; that

5 said debt is one existing in open account and was due on the 10th day of March, 1920, and no note has been received for such account, nor any judgment rendered thereon.

(Signed) W. H. EDWARDS,
Collector of Internal Revenue,
Second District of New York.

Sworn to before me this 4th day of May, 1921.
(Seal) (Signed) ARTHUR I. PERRY,
Notary Public, New York County.
County Clerk, No. 56, Register No. 2012.

Commission expires March 30, 1922.
[Title omitted.]

In United States District Court

Hearing before referee on order to show cause

Before Hon. JOHN J. TOWNSEND, referee.

Claim of collector of internal revenue

NEW YORK, *July 27, 1922, at 1.15 p. m.*

Present:
Mr. Fichandler for trustee.
J. T. Dortch, solicitor's office, Bureau of Internal Revenue.
Victor House, assistant U. S. district attorney.

6. The REFEREE. This is an order to show cause against the Bureau of Internal Revenue.

Mr. Fichandler files order to show cause. In this case the petition was filed in March of 1920. I have before me the order to show cause filed with the referee to-day. I have the claim by Collector of Internal Revenue Edwards, verified May 4, 1921.

It is stipulated that the Government for the year's income of 1917 assessed an additional tax of $2,421.75 against the bankrupt corporation on November 28th, 1919, payable by the bankrupt corporation on December 11th, 1919.

It is further stipulated that the petition in bankruptcy was filed against the taxed corporation March 20, 1920, a period of three months and 11 days after December 11th, 1919.

The Government, under section 57–J of the bankruptcy act, waives claim for the 5% penalty imposed on the $2,421.75, pursuant to revenue act of 1917.

The question for determination by the referee as a matter of law is whether or not the Government is entitled to one per cent on $2,421.75, pursuant to section 9–A of the revenue act of 1916, which by section 212 of the revenue act of 1917 is incorporated in the revenue act of 1917.

The question is whether I will allow one per cent interest after the date of the filing of the petition in bankruptcy on March 20th, 1920. Is not that so?

Mr. HOUSE. Yes, sir.

The REFEREE. Mr. Fichandler claims that it is not allowable.

Mr. FICHANDLER. It is not allowable after the date of the filing of the petition in bankruptcy.

The REFEREE. What is your authority?

7 Mr. FICHANDLER. Because there is no authority at all that gives preference to the Government. May I file a memorandum?

The REFEREE. Yes.

Mr. HOUSE. May I also file a memorandum?

The REFEREE. Yes. If there is nothing further, I will declare this hearing closed.

(Proceedings closed.)

In United States District Court

Opinion of referee

[Title omitted.]

On May 5, 1921, the United States by William H. Edwards, collector of internal revenue, second district, New York, filed a claim, as above stated, at $2,421.75, plus 5 % penalty and 1 % interest per month thereon until paid.

8 On July 29, 1922, the trustee obtained from the referee an order to show cause why the claim should not be liquidated and reduced to the sum of $2,421.75 and such order to show cause was filed with the referee July 27, 1922.

The pertinent statutes are section 14–a of Title I, Part I of the revenue act of September 8, 1916, and section 57–j of the bankruptcy act.

The language of such section 14–a is, in part, as follows: "and to any sum or sums due and unpaid after the fifteenth day of June in any year * * * there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month * * *."

Section 57–j of the bankruptcy act reads as follows:

"Debts owing to the United States, a State, a county, a district, or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

Taxes are regarded as a debt by the bankruptcy act:

In re Sherwoods, Inc., C. C. A. 2d Circuit, 31 A. B. R. 769, 772, foot page 773; 210 Fed. Red. 754.

Attention is called to the provisions of section 212 of the
9 war revenue act of October 3, 1917, extending and making applicable the provisions of the revenue act of 1916, and in particular to the language of section 212, viz: "and all provisions of Title I of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, relating to returns and payment of tax therein imposed, *including penalties*, are hereby made applicable to the tax imposed by this title."

The above italics are mine.

The importance of the italicised words is in their characterization of the provisions of section 14–a of the revenue law of 1916, under the provisions of which the United States Government makes its claim for the tax at $2,421.75 with "5% penalty and 1% interest per month thereon until paid."

The Government withdraws its claim for the expressed penalty of five per centum, but maintains its claim for the one per cent per month as interest and not as penalty.

No question as to the proper assessment of the income tax arises for determination by me under §64–a: In re Anderson, 48 A. B. R. 350.

Notwithstanding the decision of the Circuit Court of Appeals, 4th Circuit, in U. S. vs. Guest, 143 Fed. Rep. 456, I am of the opinion that the provisions of section 212 above mentioned constitute a statutory characterization or definition of the provisions of section 14–a above mentioned as being penal, both in respect to the five per cent penalty as well as in respect to the one per cent interest per month.

Accordingly, I am of the opinion that section 57–j of the bankruptcy act (in which the sovereign is named) relieves the estate in
10 bankruptcy, or rather its creditors, from the punitive provisions of section 14–a of the revenue law above mentioned and the drastic rate of interest prescribed.

This conclusion will find support in the decision of the District court of Massachusetts rendered upon a kindred statute: See In re Ashland Emory & Corundom Co., 36 A. B. R. 194; 229 Fed. Rep. 829, to which decision the following cases are contra:

In re Kallak, 17 A. B. R. 415; 147 Fed. Rep. 276;

In re G. L. Schuyler & Co., 21 A. B. R. 428;

In re Scheidt Bros., 23 A. B. R. 778; 177 Fed. Rep. 599;

Ramirez-Quinones, 39 A. B. R., 320, 323.

The trustee is entitled to an order, within section 57–j of the bankruptcy act, allowing the claimed filed by the collector of internal revenue on May 5, 1921, at $2,421.75, with interest at six per cent per annum to the date of payment.

New York, October 3, 1922.

J. J. TOWNSEND,
Referee in Bankruptcy.

11

11 In United States District Court

[Title omitted.]

Order allowing claim

Upon the proof of claim heretofore filed herein by the United States of America on May 5, 1921, for $2,421.75, with interest at the rate of 1% per month from March 10, 1920, to date of payment; the objection thereto of Edward H. Childs, trustee of the above named bankrupt, verified June 28, 1922, and the order to show cause herein dated June 29, 1922, and hearing and due deliberation having been thereupon had, it is

On motion of Zalkin & Cohen, Esqs., attorneys for the trustee,

ORDERED that the claim heretofore filed by the United States of America as aforesaid, be allowed in the sum of $2,421.75 with interest thereon at the rate of 6% per annum from March 10, 1920, to date of payment.

Dated, New York, October 27, 1922.

J. J. TOWNSEND,
Referee in Bankruptcy.

12 In United States District Court

[Title omitted.]

Petition of United States of America to review

To JOHN J. TOWNSEND, Esq.,
Referee in Bankruptcy.

The petition of Victor House, assistant United States attorney for the Southern District of New York, respectfully alleges:

That the United States of America is a creditor of J. Menist Co., Inc., the above-named bankrupt, and that its claim has been allowed herein.

That on the 27th day of October, 1922, an order, of which a copy is hereto annexed, was duly made and entered herein.

That such order is erroneous in that the same is contrary to the evidence, the weight of the evidence, and contrary to law.

Wherefore, your petitioner respectfully asks that the said order may be reviewed, as provided in the bankruptcy law of 1898 and General Order XXVII.

Dated, New York, October 27, 1922.

VICTOR HOUSE, *Petitioner.*

13 [Jurat showing the foregoing was duly sworn to by Victor House. Omitted in printing.]

14 United States District Court

[Title omitted.]

Petition of trustee to review

To the Honorable JOHN J. TOWNSEND,
Referee in Bankruptcy.

Your petitioner respectfully shows:

1. That he is trustee in bankruptcy of the above-named bankrupt.

2. That on the 27th day of October, 1922, an order, a copy of which is hereto annexed, was made and entered herein. That such order was and is erroneous in that the United States Government of America, is not entitled to any interest on the tax assessed in the sum of $2,421.75 pursuant to section 57–J of the bankruptcy act.

Wherefore, your petitioner, feeling aggrieved, because of such order, prays that the same may be reviewed as provided in the bankruptcy act of 1898 in General Order XXVII.

Dated, N. Y., October 30, 1922.

EDWARD H. CHILDS, *Petitioner.*

15 United States District Court

[Title omitted.]

Referee's certificate

To the Honorable Judges of the District Court of the United States for the Southern District of New York.

I, John J. Townsend, referee in charge of this case, do hereby certify that in the course of the proceedings had before me herein, the following question arose pertinent to the proceedings:

On May 5, 1921, the United States, by William H. Edwards, collector of internal revenue, second district, New York, filed a claim for $2,421.75 for additional income tax for year 1917 with 5% penalty and 1% interest per month.

On July 29, 1922, the trustee obtained from the referee an order to show cause why the claim should not be liquidated and reduced to the sum of $2,421.75, and such order to show cause was filed with the referee July 27, 1922.

Proceedings were thereupon had before me as shown by the accompanying stenographer's minutes, at which hearing the
16 Government under §57–J of the act waived the claim for 5% penalty imposed on the $2,421.75 pursuant to the revenue act of 1917.

After consideration of the evidence, the referee filed his memorandum, dated October 3, 1922, allowing the claim of the United States at $2,421.75, with interest at 6% per annum to the date of payment; and on October 27, 1922, filed an order to that effect.

On October 27, 1922, the United States feeling aggrieved at my order made on October 27, 1922, filed with me a petition for review, which was granted.

On October 30, 1922, the trustee feeling aggrieved at my order of October 27, 1922, filed with me his petition for review, which was granted.

The question presented on this review is whether the referee was correct in allowing the claim of the United States at $2,421.75 with interest at 6% to the date of payment.

I hand up herewith for the information of the judges, the following papers:

(1) Proof of claim of United States filed May 5, 1922.
(2) Petition and order to show cause for reexamination filed July 27, 1922.
(3) Stenographer's minutes pages 1–3.
(4) Memorandum of referee, filed October 3, 1922.
(5) Order allowing claim filed October 27, 1922.
(6) Petition for review of United States, filed October 27, 1922.
(7) Petition for review of trustee, filed October 30, 1922.

New York, November 4, 1922.

J. J. TOWNSEND,
Referee in Bankruptcy.

17 In United States District Court

[Title omitted.]

Notice of hearing on petition for review

SIR: Please take notice that upon the certificate of review of Honorable John J. Townsend, referee in bankruptcy, duly filed in the office of the clerk of this court on the 6th day of November, 1922, and upon all the proceedings heretofore had herein, the undersigned will move this court, at a term for motions, in room 235 of the Old Post Office Building, located at Park Row and Broadway, in the borough of Manhattan, city of New York, on the 15th day of

November, 1922, at 10.30 o'clock in the forenoon of that day, or as soon thereafter as counsel can be heard, for an order vacating and setting aside the order entered on October 27th, 1922, allowing the claim of the United States of America at $2,421.75 with interest at 6% per annum to date of payment, and for an order directing the claim of United States of America to be allowed in the sum of $2,421.75 without any interest, and for such other, further, and different relief as to this court may seem just and proper in the premises.

Dater, New York, November 9th, 1922.

Yours, etc.,

ZALKIN & COHEN,
Attorneys for,
No. 49 Chambers Street,
Borough of Manhattan, New York City.

To: WILLIAM HAYWARD, Esq.,
United States District Attorney,
Old Post Office Building,
Park Row and Broadway,
Borough of Manhattan, New York City.

In United States District Court

[Title omitted.]

Opinion

WILLIAM HAYWARD, United States attorney, for the collector of internal revenue; Victor House, assistant U. S. attorney, counsel. Zalkin & Cohen, solicitors for trustee in bankruptcy.

AUGUSTUS N. HAND, District Judge:

This is a proceeding based upon a certificate of review of the referee in bankruptcy, who decided that the Government's claim of $2,421.75 for additional income taxes for the year 1917, with one per cent per month interest, should be allowed with interest at only the rate of six per cent per year. The Government had originally made a claim to five per cent penalty, but withdrew that at the hearing before the referee.

The provision of law in question is section 14–a of the revenue act of 1916 made applicable to the assessment and collection of internal revenue taxes for the year 1917 by section 212 of the revenue act of 1917. Section 14–a provides:

"* * * to any sum or sums due and unpaid after the fifteenth day of June of any year, or after one hundred and five days from the date from which the return of income is required to be made by the taxpayer, and after ten days' notice and demand thereof by the Collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due."

Section 57–j of the bankruptcy act provides that:

"Debts owing to the United States, a State, a country, a district, or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

The involuntary petition in bankruptcy was filed during the month of March, 1920.

While the tax is not provable debt in such a sense as to render the United States a creditor entitled to vote for the election of a trustee, it would seem reasonably clear that section 57–j of the bank-
21 ruptcy act applies to tax penalties. It can hardly be thought that there was not an intention to include such penalties under this section when they are such an obvious and numerous class of penal obligations. In the case of In re Kallak, 147 Fed. 276, and In re Scheidt Bros., 177 Fed. 599, two District Courts have held that penalties provided for by State statutes ought to be paid in full as though no bankruptcy had intervened. In the first case, section 57–j of the bankruptcy act was not referred to, and in the second case the court held that under the law of Ohio a penalty of five per cent, which had accrued prior to the filing of the petition under the law of the State of Ohio, took the place of interest and was intended to cover interest till the delinquent taxes were put into judgment. The Circuit Court of Appeals for the Eighth Circuit reached the same conclusion in Stanard vs. Dayton, 220 Fed. 441; but the Supreme Court, in the case of Swartz vs. Hammer, 194 U. S., at page 444, seems to have affirmed a decree of the United States District Court for the Eastern District of Missouri, which disapproved penalties upon delinquent taxes that had been ordered paid by a referee in bankruptcy. Apparently, the rejection of the penalties was not raised by exceptions in the Appellate Courts, but the disposition of the district judge was affirmed in the Supreme Court without adverse criticism, although the disallowance of the penalties by the district judge was expressly referred to in the opinion.

In the case of In re Ashland, Emery Corundum & Co., 229 Fed. 829, Judge Horton held that a New Jersey franchise tax which under the New Jersey law bore interest at one per cent per
22 month until paid should be liquidated by the bankruptcy court at the face of the tax plus six per cent per year, on the ground that one per cent a month constituted a penalty.

The Circuit Court of Appeals for the Fourth Circuit in the case of United States vs. Guest, 143 Fed. 456, held that under U. S. Rev. Stat., § 3184, providing for the collection of delinquent internal revenue taxes with a penalty of five per cent thereon and interest at the rate of one per cent a month, the five per cent was a penalty but the one per cent a month was not, and that one per cent a month

could be recovered but not the five per cent where the statute of limitations had run upon actions to collect penalties.

If it be true, as I believe, that section 57–j of the bankruptcy act applies to a case of this kind, the question is whether the provision as to one per cent a month can be regarded as a penalty.

That it is called interest in the statute would certainly not be conclusive upon bankruptcy courts if a State statute were involved. See In re Ashland, Emery, Corundum & Co., supra (at page 831); New Jersey vs. Anderson, 203 U. S. 483.

While the situation may be different where clauses of two separate acts of Congress are to be harmonized when Congress used the word "interest" in providing by section 14–a of the revenue act what should be imposed for failing to pay income taxes, I can hardly suppose that it intended to exclude the interest clause of one per cent per month from the provisions of section 57–j of the bankruptcy act. I believe the word "interest" used in section 14–a was a natural one to describe a sum to be added to delinquent taxes at the rate of
23 one per cent per month. I do not regard it as a term intended to distinguish between penal and other provisions of the act.

Judge Morton in the case of In re Ashland, Emery & Corundum Co., supra, quoted from the opinion of Mr. Justice White in Sun Printing Ass'n vs. Moore, 183 U. S. 672, and held that where there is an excessive disproportion between the sum due and the possible damages resulting from a breach, the question of disproportion is an element entering into the consideration of whether the parties intended to fix the damages or to stipulate the payment of an arbitrary sum as a penalty. Judge Morton held that one per cent a month plainly exceeded what was fairly required to make good loss to the State from delay in payment of taxes, and consequently constituted a penalty imposed for failure to pay promptly. He accordingly allowed in that case only six per cent, which was the rate of interest for individuals established by statute in New Jersey, the State where the taxes were due. This rate of interest is probably more common than any other within the United States, and it is to be noted that under section 6407, United States Compiled Statutes, if a plaintiff secures a judgment against the United States and the Secretary of the Treasury asserts a set-off, any balance found to be payable by the United States over and above the lawful set-off bears interest at six per cent.

The referee in bankruptcy held, as did Judge Morton, that six per cent was a fair measure of damages for the failure to pay taxes, and such a disposition of the case seems to me so reasonable that the order is affirmed.

December 5, 1922.

A. N. H., *D. J.*

24 In United States District Court

[Title omitted.]

Order of District Court affirming referee's order

A motion having duly come on to be heard to review the order of Honorable John J. Townsend, dated October 27th, 1922, allowing the claim of the United States of America in the sum of $2,421.75, with interest thereon at the rate of 6% per annum from March 10th, 1920, to date of payment.

Now, upon reading the proof of claim of the United States of America filed May 5th, 1922, the petition and order to show cause for reexamination filed July 27th, 1922, the stenographer's minutes taken before the referee, the memorandum of the referee filed October 3rd, 1922, the order allowing the claim, filed October 27th, 1922, the petition for review of the United States of America, filed October 27th, 1922, the petition for review of the trustee, filed October 3rd, 1922, the referee's certificate of review filed November
25 6th, 1922, and the notice of motion to review the said referee's order with proof of service thereof upon William Hayward, the United States attorney for the Southern District of New York, and after hearing Vincent T. Follmar, Esquire, on behalf of the trustee and Victor House, Esquire, of counsel, on behalf of the United States of America, and after due deliberation having been had, and upon filing the opinion of the court, it is

ORDERED that the petition to review, filed by the trustee in bankruptcy herein, and the United States of America be and hereby are dismissed; and it is further

ORDERED that the order entered in the office of Honorable John J. Townsend, referee in bankruptcy, allowing the claim of the United States of America in the sum of $2,421.75, with interest thereon at the rate of six per cent (6%) per annum from March 10th, 1920, to date of payment, be and hereby is in all respects affirmed.

Dated, N. Y., December 21, 1922.

AUGUSTUS N. HAND, *U. S. D. J.*

26 In United States Circuit Court of Appeals

[Title omitted.]

Petition to United States Court of Appeals to revise

To the Honorable the Judges of the United States Circuit Court of Appeals for the Second Circuit:

The petition of the United States of America, a corporation sovereign, and Frank K. Bowers, collector of internal revenue for the second district of New York, respectfully shows to this court:

That on the 5th day of May, 1921, the collector of internal revenue for the second district of New York filed proof of claim on behalf of the United States of America herein with Honorable John

J. Townsend, referee in bankruptcy, for additional income tax for the year 1917 in the sum of $2,421.75, with 5% penalty and interest at the rate of 1% per month from March 10, 1920, to date of payment.

27 That thereafter said claimant duly waived claim to the penalty of 5% hereinabove mentioned.

That on June 28, 1922, Edward H. Childs, Esq., the trustee herein, filed a petition with said referee, and that on June 29, 1922, an order was signed thereon by said referee directing the collector of internal revenue for the second district of New York to show cause why the claim above mentioned should not be liquidated and reduced to the sum of $2,421.75 without interest. That William Hayward, Esq., United States attorney for the Southern District of New York, duly appeared on behalf of the United States of America and said collector of internal revenue in opposition to said order to show cause; that a hearing was thereupon duly had upon said order to show cause, and that said referee thereafter on October 3, 1922, duly filed a memorandum setting forth his opinion in respect to said claim and the allowance of interest thereon. That thereafter on October 27, 1922, said referee duly made an order directing that the aforesaid claim of the United States of America be allowed in the sum of $2,421.75, with interest thereon at the rate of 6% per annum from March 10, 1920, to date of payment.

That on October 27, 1922, a petition was duly filed herein with said referee by Victor House, assistant United States attorney for the Southern District of New York, on behalf of the United States of America, asking for a review of said order of said referee as provided for in the bankruptcy law of 1898 and General Order XXVII, by the United States District Court for the Southern District of New York, upon the ground that said order was erroneous in that the same was contrary to the evidence, the weight of the evidence, and contrary to law.

28 That on October 30, 1922, said Edward H. Childs, the trustee in bankruptcy herein, duly filed his petition for a review of said order of Referee John J. Townsend, dated October 27, 1922, pursuant to the bankruptcy act of 1898 and General Order XXVII, upon the ground that said order was erroneous in that said United States of America was not entitled to any interest upon its claim in the sum of $2,421.75.

That thereupon on November 6, 1922, said referee duly filed herein his certificate of review and the papers upon which the same was made.

That thereafter on November 9, 1922, Zalkin & Cohen, Esqs., solicitors for the trustee herein, duly filed their notice of motion herein in the United States District Court for the Southern District of New York for an order vacating and setting aside said order of Referee John J. Townsend entered on October 27, 1922, and directing said claim to be allowed in the sum of $2,421.75, without any interest.

That thereafter a hearing was duly had before Honorable Augustus N. Hand, United States district judge for the Southern District of New York, on said proof of claim of the United States of America, the petition and order to show cause filed by the trustee herein for the liquidation and reduction of said claim to the sum of $2,421.75 without interest, and on all the papers filed and proceedings had herein.

That on December 5, 1922, said Honorable Augustus N. Hand, as such United States district judge, filed his opinion herein, and that on December 21, 1922, an order was made and entered herein in the United States District Court for the Southern District of
29 New York, dismissing said petitions to review said order of Honorable John J. Townsend, referee in bankruptcy herein, and in all respects affirming the order of said Honorable John J. Townsend, referee in bankruptcy, allowing the claim of the United States of America in the sum of $2,421.75 with interest thereon at the rate of 6% per annum from March 10, 1920, to date of payment.

Your petitioners further aver that the said order or judgment or decree of the said District Court made and entered herein on December 21, 1922, was and is erroneous in matters of law in that the said District Court committed the following errors:

First. That the United States District Court for the Southern District of New York erred in dismissing the claimant's petition for review of the order made by Honorable John J. Townsend, referee in bankruptcy, on October 27, 1922.

Second. That the said court in its order affirming the order of said Honorable John J. Townsend, referee in bankruptcy, dated October 27, 1922, and the opinion upon which the said order was based, erred in allowing the claim of the United States of America herein in the sum of $2,421.75, with interest thereon at the rate of 6% per annum from March 10, 1920, to date of payment, in so far as said order and the opinion upon which said order was based failed to allow interest upon said claim of said United States of America at the rate of 1% per month for the period specified.

Third. That the said court in its order affirming said order
30 of said referee and in its opinion upon which the said order was based, erred in so far as said order and said opinion found and decided that the United States of America was entitled to interest upon its claim herein for $2,421.75 at the rate of 6% per annum from March 10, 1920, to date of payment, instead of interest at the rate of 1% per month for said period.

Fourth. That the said court in its said order affirming said order of said referee and in the opinion upon which its said order was based, erred in failing to allow the claim heretofore filed by the United States of America in the sum of $2,421.75, with interest thereon at the rate of 1% per month from March 10, 1920, to date of payment.

Wherefore, your petitioners feeling aggrieved because of said order or judgment or decree pray that the same may be revised in matter

of law by your honorable court as provided in paragraph 24-b of the bankruptcy act of 1898 and the rules and practice in such case made and provided.

UNITED STATES OF AMERICA
AND FRANK K. BOWERS,
Collector of Internal Revenue,
By WILLIAM HAYWARD,
United States Attorney
for the Southern District of New York.

31 [Jurat showing the foregoing was duly sworn to by Victor House omitted in printing.]

32 In United States District Court

[Title omitted.]

Petition for and order allowing appeal

To the Honorable the Judges of the United States District Court for the Southern District of New York:

The United States of America and Frank K. Bowers, collector of internal revenue for the second district of New York, feeling aggrieved by the order and decree of the United States
33 District Court for the Southern District of New York, made by the Honorable Augustus N. Hand, one of the judges thereof, and entered herein on the 21st day of December, 1922, in the above-entitled proceeding, affirming an order of John J. Townsend, Esq., referee in bankruptcy, dated October 27, 1922, allowing the claim of the United States of America herein in the sum of $2,421.75, but limiting the recovery of interest upon said claim to the rate of 6% per annum from March 10, 1920, to date of payment, instead of allowing the recovery of such interest at the rate of 1% per month for said period, do hereby petition for an appeal upon the said order and decree to the United States Circuit Court of Appeals for the Second Circuit, to do and receive what may appertain to justice to be done in the premises, and that a transcript of the record, proceedings, and evidence in said proceeding duly authenticated, may be transmitted to the United States Circuit Court of Appeals for the Second Circuit.

Date, New York, December 30, 1922.

UNITED STATES OF AMERICA
and FRANK K. BOWERS,
Collector of Internal Revenue
for the Second District of New York.
By WILLIAM HAYWARD,
United States Attorney for the
Southern District of New York,

The foregoing appeal is hereby allowed.
Dated, New York, December 30, 1922.

J. W. MACK, *U. S. D. J.*

34 In United States District Court

[Title omitted.]

Notice of appeal

SIRS: Please take notice that the United States of America and Frank K. Bowers, collector of internal revenue for the second district of New York, hereby appeal from the order and decree of the United States District Court for the Southern District of New York made by Honorable Augustus N. Hand, one of the judges thereof, and entered herein on the 21st day of December, 1922, affirming an order of John J. Townsend, Esq., referee in bankruptcy, dated October 27, 1922, whereby the United States of America is allowed interest upon its claim herein for additional taxes for the year 1917, amounting to $2,421.75 at the rate of six per cent per annum from March 20, 1920, to date of payment, instead of at the rate of one per cent per month for said period, to the Circuit Court of
35 Appeals for the Second Circuit, to be held in and for said circuit at the United States Courts and Post Office Building, in the borough of Manhattan, city of New York.

Dated, New York, December 30, 1922.

Yours, etc.,

WILLIAM HAYWARD,
United States Attorney for the
Southern District of New York,
Attorney for United States of
America and Frank K. Bowers,
Collector of Internal Revenue
for the Second District of New York,
Office & Post Office Address, U. S.
Courts & Post Office Building,
Borough of Manhattan, City of New York.

To ZALKIN & COHEN, Esqs.,
Attorneys for Trustee in Bankruptcy,
49 Chambers Street, New York City.
ALEXANDER GILCHRIST, Jr., Esq.,
Clerk of the U. S. District Court,
Southern District of New York.

36 In United States District Court

[Title omitted.]

Assignment of errors

Now come the United States of America and Frank K. Bowers, collector of internal revenue for the second district of New York, and file the following assignment of errors:

First. That the United States District Court for the Southern District of New York erred in dismissing the claimant's petition for review of the order made by Honorable John J. Townsend, referee in bankruptcy, on October 27, 1922.

Second. That the said court in its order affirming the order of said Honorable John J. Townsend, referee in bankruptcy, dated October 27, 1922, and the opinion upon which the said order was based, erred in allowing the claim of the United States of America herein in the sum of $2,421.75, with interest thereon at the rate of 6% per annum from March 10, 1920, to date of payment, in so far as said order and the opinion upon which said order was based failed to allow interest upon said claim of said United States of America, at the rate of 1% per month for the period specified.

37 Third. That the said court in its order affirming said order of said referee and in its opinion upon which the said order was based, erred in so far as said order and said opinion found and decided that the United States of America was entitled to interest upon its claim herein for $2,421.75 at the rate of 6% per annum from March 10, 1920, to date of payment, instead of interest at the rate of 1% per month for said period.

Fourth. That the said court in its said order affirming said order of said referee, and in the opinion upon which its said order was based, erred in failing to allow the claim heretofore filed by the United States of America in the sum of $2,421.75, with interest thereon at the rate of 1% per month from March 10, 1920, to date of payment.

Wherefore the United States of America prays that the said order and decree herein for the manifest errors aforesaid, and for other errors in the record and proceedings herein, may be reversed and for naught held and esteemed; and that it may be restored to all matters and things which it has lost by reason of said order and decree, and that the United States District Court for the Southern District of New York may be directed to enter an order and decree herein allowing interest upon the claim of the United States of America as filed for $2,421.75, with interest at the rate of 1% per month from March 10, 1920, to date of payment.

Dated, New York, December 30, 1922.

WILLIAM HAYWARD,
United States Attorney for the
Southern District of New York.

38 [Citation in usual form omitted in printing.]

39 In United States District Court

[Title omitted.]

Stipulation re transcript of record

It is hereby stibulated and agreed that the foregoing is a true transcript of the record of the United States District Court for the

Southern District of New York in the above entitled matter, as agreed on by the parties.

Dated, New York, January 30, 1923.

WILLIAM HAYWARD,
United States Attorney for the Southern District of New York,
Attorney for Appellant.

ZALKIN & COHEN,
Attorneys for Appellee.

40 In United States District Court

[Title omitted.]

Clerk's certificate

I, Alexander Gilchrist, jr., clerk of the District Court of the United States of America for the Southern District of New York, do hereby certify that the foregoing is a correct transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

41 In testimony whereof, I have caused the seal of the said court to be hereunto affixed, at the city of New York, in the Southern District of New York, this 1st day of February, in the year of our Lord one thousand nine hundred and twenty-three and of the independence of the said United States the one hundred and forty-seventh.

[SEAL.] ALEX. GILCHRIST, Jr., *Clerk.*

42 In United States District Court

[Title omitted.]

Stipulation re questions for determination by Circuit Court of Appeals

Whereas, on October 27th, 1922, John J. Townsend, referee in bankruptcy, duly made an order directing that the claim of United States of America filed herein in the sum of $2,421.75 be allowed in that sum with interest thereon at the rate of six (6%) per cent per annum from March 10th, 1920, to date of payment, and

Whereas, on the 27th day of October, 1922, a petition was duly filed herein with said referee by Victor House, assistant United States attorney for the Southern District of New York, on behalf of United States of America for a review of said order, and

Whereas, on October 30th, 1922, Edwards H. Childs, trustee in bankruptcy herein, duly filed his petition for review of said order with Referee Townsend, upon the ground that said order was erroneous in that said United States of America was not entitled to any interest upon its claim, and

43 Whereas, an order was duly entered by Hon. Augustus N. Hand, United States district judge, on the 21st day of Decem-

ber, 1922, dismissing said petition to review, and in all respects affirming the order of said John J. Townsend, referee in bankruptcy, allowing the claim of United States of America in the sum of $2,421.75 with interest thereon at the rate of six (6%) per cent. per annum from March 10th, 1920, to date of payment,

Now, therefore, it is hereby stipulated and agreed, by and between the attorneys for the trustee and the attorney for the United States of America, that the Circuit Court of Appeals for the Second Circuit may, in addition to the questions raised by the record on appeal, determine the following questions:

1. Whether the United States of America is entitled to any interest on its claim in the sum of $2,421.75 after the adjudication in bankruptcy herein.

2. If the United States of America is entitled to interest upon its claim, whether the rate of interest is 1% a month or 6% per annum from March 10th, 1920, to date of payment.

Dated, New York, January 30th, 1923.

ZALKIN & COHEN,
Attorneys for Trustee.
WILLIAM HAYWARD,
Attorney for United States of America.

44 United States Circuit Court of Appeals for the Second Circuit

In the matter of J. MENIST CO., INC., BANKRUPT
UNITED STATES OF AMERICA, APPELLANT } *Opinion*

Appeal from an order in bankruptcy entered in the District Court for the Southern District of New York.

The petition in this matter was filed 20th March, 1920.

On 28th November, 1919, the United States had assessed on Menist's income for 1917 an additional tax of $2,421.75, and required the corporation to pay the same on December 11, 1919. No payment was made.

On 5th May, 1921, the United States filed a claim in this proceeding for the said tax plus five per cent penalty and one per cent interest per month until paid.

That the tax was duly levied and is correct in amount are matters not in controversy.

45 The statutory justification asserted for the demand of interest and penalties is act of October 3, 1917 (40 Stat. 300, sec. 212), making sec. 14 (a) of the act of September 8, 1916 (39 Stat. 756), applicable to taxes under the 1917 act.

By these statutes it is provided that:

"* * * to any sum or sums due and unpaid after the fifteenth day of June of any year, or after one hundred and five days from the date from which the return of income is required to be made by the taxpayer, and after ten days' notice and demand thereof by the Collector, there shall be added the sum of five per centum on the

amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due."

At the hearing below the United States withdrew its claim for the penalty of five per centum, but insisted upon the demand for one per centum per month under the guise of lawful interest.

The lower court held that so-called interest at the rate of one per cent a month amounted to a penalty, and therefore allowed the tax with interest at six per cent to be computed to the day of the date of payment by the trustee.

There appears to be an error in the transcript as to the time when interest should begin. It has not been insisted upon in argument and may be corrected by agreement.

From the order embodying this decision the present appeal was taken.

Victor House, assistant U. S. attorney, for appellant; E. Fichandler for the trustee in bankruptcy.

46 HOUGH, *C. J.*:

The fundamental proposition thought to justify this appeal is that a tax is not a debt. This is usually true; taxes are not treated as debts, because the latter are obligations founded on contract, while taxes are imposts levied by government and operating in invitum. (Meriwether vs. Garrett, 102 U. S. 472, at 313–514.)

But we are here concerned only with the bankruptcy statute, and a tax whether due to the nation, to a state or any other lawful taxing power, is a species of debt under that act. This is because it is called a debt by the statutory caption of sec. 64, which is the law invoked, and properly invoked, by the Government in pursuing its present demand. (30 Stat., p. 563.) Further, this court has so decided In re Sherwoods, 210 Fed. 754 (758), and the point is elaborately and well treated in Kaw, etc., vs. Schull, 230 Fed. 587.

A tax being then a preferred debt; neither interest nor any other derivative or appended claim can rise higher than the tax debt which gives it birth and being; and it is provided in respect of all debts "owing to the United States, a state, a county, etc." as a penalty, shall not be allowed except for the amount of the pecuniary loss sustained in the proceeding out of which the penalty arose. (Sec. 57–j.)

47 It is a matter almost too plain to require citation, that an exaction may be a penalty without being called by that name. Fontenot vs. Accardo, 278 Fed. 871, at 874.) The question is often one of degree, for on one would doubt that if the statutory rate for withholding a tax was one per cent a day, the requirement would be treated as a penalty.

Subject to statutory limitation, the rate of interest or, what is the same thing, compensation for the use of money, is ordinarily fixed by agreement of parties. But in tax matters there is no such agreement; one party commands and the other must obey, and again subject to constitutional limitations the commanding party may impose any terms of payment that it pleases, and it makes no difference

whether the price of delayed obedience is called interest or penalty or fine or additional tax; every increase over the amount that satisfies the tax if paid the moment it is levied, is merely an additional exercise of the power of the taxing authority.

Since in bankruptcy (and we are solely concerned with bankruptcy) the power of ascertaining the amount or legality of any tax is vested in the court (sec. 64–a) and penalties are not to be allowed except for the amount of pecuniary loss sustained by the delayed payment, the only question here is whether an exaction of one per cent a month as the price of delay amounts to a penalty. (As to nature of interest generally see Agency, etc., Co. vs. American Co., 258 Fed. 363, at 372.)

On the point at bar we are in accord with Re Ashland, etc.,
48 Co., 229 Fed. 829, and hold that there being no evidence of any injury or damage to the Government by the withholding of this tax except that which flows from the nonpayment of a just debt, anything in excess of the legal rate of interest is to be treated as a penalty and not allowed.

The point seems not to have been argued in Re Kallak, 147 Fed. 276, In re Scheidt, 177 Fed. 599, or In re Quinones, 39 A. B. R. 320; but in the implications of these cases we can not concur. As the question here arises under the bankruptcy act, United States vs. Guest, 143 Fed. 456, does not apply; there being no reason why a penalty, by whatever name called, may not be enforced against an individual—if properly expressed in agreement or statute.

The question remains whether a tax demand duly proved should continue to draw interest at the legal rate after the filing of petition for adjudication. The general rule is, of course, that interest stops with petition filed (Sexton vs. Dreyfuss, 219 U. S. 339), but a tax debt due to any of the taxing authorities enumerated in sec. 64 A is not only a highly preferred debt, but the section contains specific directions that the trustee shall pay "all taxes legally due and owing." That means legally due and owing in accordance with the provisions of the bankruptcy act, and under that statute sec. 27–j
requires penalties due to the United States, or a State, etc., to
49, 50 be allowed to the extent of the pecuniary loss suffered. The loss continues as much after petition filed as before.

We agree with the court below that these directions can not be fulfilled except by an order on the trustee to pay the tax with lawful interest down to the date of actual payment.

Order affirmed.

51, 52 In United States Circuit Court of Appeals

[Title omitted.]

Judgment—Filed April 26, 1923

Appeal from the District Court of the United States for the Southern District of New York.

This cause came on to be heard on the transcript of record from the District Court of the United States for the Southern District of New York, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be, and it hereby is, affirmed.

It is further ordered that a mandate issue to the said District Court in accordance with this decree.

H. W. R.
C. M. H.

53 In United States Circuit Court of Appeals

Clerk's certificate

UNITED STATES OF AMERICA,
Southern District of New York, ss.

I, William Parkin, clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 52, inclusive, contain a true and complete transcript of the record and proceedings had in said court, in the case of—in the matter of J. Menist Company, Inc., bankrupt; United States, appellant, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said court to be hereunto affixed, at the city of New York, in the Southern District of New York, in the Second Circuit, this 16th day of May, in the year of our Lord one thousand nine hundred and twenty-three, and of the independence of the said United States the one hundred and forty-seventh.

[SEAL.] WM. PARKIN, *Clerk*.

54 *Writ of certiorari and return—Filed October 24, 1923.*

UNITED STATES OF AMERICA, ss:

The President of the United States of America to the Honorable the Judges of the United States Circuit Court of Appeals for the Second Circuit, Greeting:

Being informed that there is now pending before you a suit in which the United States of America is appellant and Edward H. Childs, trustee in bankruptcy, is appellee, which suit was removed into the said Circuit Court of Appeals by virtue of an appeal from the District Court of the United States for the Southern District of New York, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said Circuit Court of Appeals and removed into
55 the Supreme Court of the United States, do hereby command you that you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the

said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the Honorable William H. Taft, Chief Justice of the United States, the eleventh day of October, in the year of our Lord one thousand nine hundred and twenty-three.

WM. R. STANSBURY,
Clerk of the Supreme court of the United States.

56 (Indorsement:) File No. 29667. Supreme Court of the United States, No. 357, October Term, 1923. The United States of America vs. Edward H. Childs, trustee in bankruptcy of J. Menist Company. Writ of certiorari.

57 In the Supreme Court of the United States
October term, 1923

UNITED STATES, PETITIONER, v. EDWARD H. CHILDS, TRUSTEE, RESPONDENT.	No. 357.

Stipulation as to return to writ of certiorari

It is hereby stipulated by counsel for the parties to the above-entitled cause that the certified copy of the transcript of the record now on file in the Supreme Court of the United States shall constitute the return of the clerk of the United States Circuit Court of Appeals for the Second Circuit to the writ of certiorari granted therein.

JAMES M. BECK,
Solicitor General.
MOSES COHEN,
Counsel for Respondent.

OCT. 15, 1923.

58 *To the Honorable the Supreme Court of the United States, Greeting:*

The record and all proceedings whereof mention is within made, having lately been certified and filed in the office of the clerk of the Supreme Court of the United States, a copy of the stipulation of counsel is hereto annexed and certified as the return to the writ of certiorari issued herein.

Dated New York, October 18, 1923.

[SEAL.]

WM. PARKIN,
Clerk of the United States Circuit Court of Appeals for the Second Circuit.

59, 60 [File indorsements omitted.]

○

IN THE

Supreme Court of the United States,

OCTOBER TERM, 1924—No. 80.

THE UNITED STATES OF AMERICA,
Petitioner,

—against—

EDWARDS H. CHILDS, Trustee in Bankruptcy of J. Menist Company, Inc.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

ZALKIN & COHEN,
Attorneys for Respondent,
Office & P. O. Address,
No. 49 Chambers Street,
Borough of Manhattan,
New York, N. Y.

MOSES COHEN,
Of Counsel.

Court Press, N. Y. C. Bowling Green, 2820

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1924—No. 80.

THE UNITED STATES OF AMERICA,
Petitioner,

—against—

EDWARDS H. CHILDS, Trustee in Bankruptcy of J. Menist Company, Inc.

RESPONDENT'S BRIEF.

POINT I.

The Government is not entitled to interest upon its claim for taxes after the filing of the petition in bankruptcy.

Section 57-j of the Bankruptcy Act, which provides for the manner of the payment of obligations due the United States, reads as follows:

> "Debts owing to the United States, a State, a county, a district or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction,

> or proceeding out of which the penalty or forfeiture, arose, with reasonable and actual costs occasioned thereby and *such interest as may have accrued thereon according to law.*"

The Government contends taxes are not debts. The courts, however, have passed upon this specific question and have held that taxes are regarded as debts under the Bankruptcy Act.

> *In re Sherwoods*, 210 Fed. Rep. 254, 258;
> *Kaw Boiler Works* v. *Schull*, 230 Fed. Rep. 587, 589.

Since taxes are regarded as debts under the Bankruptcy Act, can the Government claim any interest after the date of the filing of the petition in bankruptcy?

This Court has held that the United States is bound by the Bankruptcy Act.

> *Guarantee Co.* v. *Title Guaranty Co.*, 224 U. S. 152;
> *U. S. Fidelity Co.* v. *Bray*, 225 U. S. 205;
> *United States* v. *Wood*, 290 Fed. 109 (affd. 163 U. S. 680).

After comparing the provisions of the Acts of 1867 and 1898 and indicating other changes, Mr. Justice McKenna in *Guarantee Co.* v. *Title Guaranty Co.*, *supra*, at page 160, says:

> "The act (of 1898) takes into consideration, we think, the whole range of indebtedness of the bankrupt, national, state and

individual, and assigns the order of payment."

In the determination of the question as to whether Federal taxes bear interest, not only must Section 14-a of the Revenue Act be read in conjunction with Section 57-j of the Bankruptcy Act, as argued by the Government, but Section 63-a of the Bankruptcy Act must likewise be considered.

Section 63-a of the Bankruptcy Act provides:

> "Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, *and with any interest thereon which would have been recoverable at that date* or with a rebate of interest upon such as were not then payable and did not bear interest."

Debts do not bear interest after the filing of the petition in bankruptcy.

Sexton v. *Dreyfus*, 219 U. S. 339.

In *Sexton* v. *Dreyfus*, *supra*, Mr. Justice Holmes says, on page 344:

> "For more than a century and a half the theory of the English bankrupt system has been that everything stops at a certain date. Interest was not computed beyond the date of the commission. *Ex parte Bennet*, 2 Atk. 527. This rule was applied to mortgages as well as to unsecured debts; *Ex parte Wardell*, 1787; *Ex parte Hercy*, 1792, 1 Cooke, Bankrupt Laws, 4th ed. 181;

(1st ed., Appendix), and notwithstanding occasional doubts, it has been so applied with the prevailing assent of the English judges ever since. *Ex parte Badger*, 4 Ves. 165. *Ex parte Ramsbottom*, 2 Mont. & Ayrt. 79. *Ex parte Penfold*, 4 De G. & Sm. 282. *Ex parte Lubbock*, 9 Jr. N. S. 854. *In re Savin*, L. R. 7 Ch. 760, 764. *Ex parte Bath*, 22 Ch. Div. 450, 454. *Quartermaine's Case* (1892), 1 Ch. 639. *In re Bonacino*, 1 Manson, 59. As appears from *Cooke*, *supra*, the rule was laid down not because of the words of the statute but as a fundamental principle. We take our bankruptcy system from England, and we naturally assume that the fundamental principles upon which it was administred were adopted by us when we copied the system, somewhat as the established construction of a law goes with the words where they are copied by another State. *No one doubts that interest on unsecured debts stops.* See Sec. 63 (1). *Board of County Commissioners* v. *Hurley*, 169 Fed. Rep. 92, 94."

Section 57-j of the Bankruptcy Act provides for the payment of "such interest as may have accrued thereon according to law." What other law could have been intended other than the law that a debt bears interest until the date of the filing of the petition in bankruptcy? The rule is not only logical but equitable. Assuming a tax had been duly assessed against a bankrupt whose estate consists wholly of a number of choses in action, is the Government's claim for taxes to increase continuously by the accrual of interest to the detriment of general creditors while the trustee is endeavoring to realize on the assets?

The Bankruptcy Act contemplates equality

among creditors while recognizing the Government's preference for taxes. Can it logically be argued that a proper construction of this Act contemplates that not only shall the Government have a preference of the principal of its claim but that pending the administration of an estate there should be permitted to accrue in favor of the Government an additional preference for interest upon its tax claim while the claims of general creditors remain *in status quo?*

In the case of *Swarts* v. *Hammer,* 194 U. S. 441, the referee allowed a tax bill together with accrued penalties and fees provided by law.

On review the District Court affirmed the order as to the amount of the taxes, but disapproved it as to penalties or fees. It does not appear that exception was taken to that portion of the order disallowing penalties and fees. Neither the Court of Appeals nor the Supreme Court was called upon to consider that question.

POINT II.

If the Government is entitled to interest on its claim until paid the rate of interest should not be more than 6% per annum.

Under Section 6407 of the United States Compiled Statutes, if a plaintiff secures a judgment against the United States and the Secretary of the Treasury asserts a set-off, any balance found to be payable by the United States over and above the lawful set-off bears interest at six per cent.

Mr. Justice White in *Sun Printing Ass'n* v. *Moore*, 183 U. S. 672, held that where there is an excessive disproportion between the sum due and the possible damages resulting from a breach, the question of disproportion is an element entering into the consideration of whether the parties intended to fix the damages or to stipulate the payment of an arbitrary sum as a penalty.

There has been some conflict of authority on this question, but we submit that the reasoning in *Re Ashland, Emery & Corundum Co.*, 229 Fed. Rep. 829, which was followed by both the District Judge and the Circuit Court of Appeals, is sound in principle and a proper interpretation of the Bankruptcy Act.

In that case the Court said, at page 831:

> "If the charge here in controversy is to be regarded as interest, the trustee ought to pay it. Penalties, however, stand upon a different footing. It cannot be said that a penalty imposed for failure to pay a tax, is part of the original tax, in the sense that interest is. By 'interest' is ordinarily understood a charge for the use of money or damages for the detention of it. A penalty, as applied to cases of this character, means a punishment imposed for failure to make the payment on time. Section 64-a contains no provision for the payment of penalties; and I do not think it can fairly be construed to include them, especially when, as here, the estate was in course of administration during the entire period when they accrued."

And again, at page 832:

> "Assuming, however, that it is, it seems to me plain, and I accordingly find, that 1% a month exceeds what is fairly required to make good a loss to the state for mere delay in the payment of the tax, and as to such excess is not interest, but constitutes a penalty imposed for failure to pay promptly. The actual damages sustained by the State of New Jersey from the delay are not obscure nor difficult to estimate. What the state lost was the use of the money. Its damages, therefore, are the commonest form known to the law, and the most certain of estimation. They are established by statute in New Jersey for individuals at 6% per annum."

In the case of *New York* v. *Jersawit*, 263 U. S. 493, the case involved the construction of the statute of the State of New York which provides for the payment of delinquent tax of 10% of said amount, plus 1% for each month the tax remains unpaid. Mr. Justice Holmes in writing the unanimous opinion of the Court, says, on page 496:

> "There can be no doubt that the additional ten per centum charged for failure to pay by January 1, is a penalty, disallowed by the Bankruptcy Act, Sec. 57-j, but it is urged that the one per centum for each month of default is statutory interest and that the State is entitled to that and otherwise would be entitled to none. As the one per centum is more than the value of the use of the money and is added by the statute to the ten to make a single sum it must be treated as part of one *corpus* and must fall with that. We presume that in this event the State does not object to receiving the simple interest allowed."

The Government contends that in *New York* v. *Jersawit, supra*, the wording of the New York Statute did not designate 1% as interest; but from the opinion of this Court it appears that the State of New York contended in its argument before this Court, that the 1% per month for the default in the payment of the tax is a statutory interest. This Court, however, held that it was in the nature of a penalty.

In re Clark Realty Co., 253 Fed. Rep. 938, involved a claim by the holder of tax sales certificates wherein the claimant was endeavoring to recover the rate of interest allowed by the law of the State of Wisconsin for the redemption of property sold for taxes. The Court held that the claimant was entitled only to 6% per annum.

In re Dayton, trustee, etc. v. *Standard Treasurer of Pueblo County, Colorado*, 241 U. S. 588, the controversy arose out of a sale for taxes on real property belonging to a bankrupt estate then in the course of administration in a Court of Bankruptcy. Mr. Justice Van Devanter, on page 590, says:

> "And while we are of opinion that the certificate holders were entitled to interest upon the amounts paid at the ordinary legal rate, applicable in the absence of an express contract, we think they were not entitled to the larger interest required to be paid on redemption from tax sales."

The conclusion therefore is inescapable that in the absence of proof of pecuniary loss by the United States Government interest at the rate of

1% per month is a penalty within the language of Section 57-j of the Bankruptcy Act and is not an allowable claim.

POINT III.

The judgment of the Circuit Court of Appeals should be affirmed.

Respectfully submitted,

MOSES COHEN,
Attorney for Respondent.

In the Supreme Court of the United States

OCTOBER TERM, 1924

UNITED STATES OF AMERICA, PETITIONER
v.
EDWARD H. CHILDS, TRUSTEE in BANKRUPTCY of J. Menist Company (Inc.) } No. 80

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF ON BEHALF OF THE UNITED STATES

By this writ of certiorari the United States seeks to review a judgment of the Circuit Court of Appeals for the Second Circuit affirming an order in bankruptcy of the District Court for the Southern District of New York disallowing interest at the rate of 1 per cent per month on a claim of the United States for taxes and allowing interest at the rate of only 6 per cent per year.

STATEMENT

On September 30, 1919, the United States assessed against the corporate income of J. Menist Company, Incorporated, an additional tax of $2,421.75 for the taxable year 1917, and demanded that the same be paid on or before December 11, 1919. No payment

was made and the corporation was adjudged bankrupt on April 6, 1920.

On May 5, 1921, the United States, through the Collector of Internal Revenue for the Second Collection District of New York, filed a claim in the Bankruptcy court for the said tax plus 5 per cent penalty and 1 per cent per month interest until paid. Under the provisions of Section 57–j of the Bankruptcy Act, the United States withdrew its claim for the penalty of 5 per cent, but insisted that interest at the rate of 1 per cent per month from ten days after due notice and demand for the payment of the tax should be allowed.

The District Court held that interest at the rate of 1 per cent per month was a penalty, and therefore declined to allow interest at that rate, but did allow interest at the rate of 6 per cent per year. That judgment was affirmed by the Circuit Court of Appeals, and its judgment now comes before this Court for review.

QUESTION INVOLVED

Is interest at the rate of 1 per cent per month, as provided by the Federal Internal Revenue laws, collectible after due notice and demand from the estate of a bankrupt?

STATUTES INVOLVED

Section 212 of the Act of October 3, 1917 (40 Stat., chap. 63, p. 300), makes Section 14(a) of the Act of September 8, 1916 (39 Stat., chap. 463, p. 756),

applicable to taxes under the Act of 1917. Section 14 (a) provides that:

> * * * to any sum or sums due and unpaid after the fifteenth day of June of any year, or after one hundred and five days from the date from which the return of income is required to be made by the taxpayer, and after ten days' notice and demand thereof by the Collector, there shall be added the sum of five per centum on the amount of tax unpaid *and interest at the rate of one per centum per month upon said tax from the time the same becomes due.*

Section 57–j of the Bankruptcy Act (30 Stat., chap. 541, p. 544) provides:

> Debts owing to the United States, a State, a county, a district, or a municipality as a penalty or forfeiture shall not be allowed except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby *and such interest as may have accrued thereon according to law.* [Italics ours.]

ARGUMENT

I

The Government is entitled to interest upon its claim at the rate of 1 per centum per month

The error in the instant case lies in the Court having almost entirely confined its consideration to the provisions of Section 57-j of the Bankruptcy Act, practically ignoring the equally important and

pertinent provisions of Section 14(a) of the Revenue Act. Inasmuch as the question involved is as much one of taxation as of bankruptcy, these two sections must be construed consistently with each other and so that the one will explain and support and not defeat or destroy the other.

While Section 57-j of the Bankruptcy Act forbids the allowance of penalties against the estate of a bankrupt it specifically allows "*such interest as may have accrued * * * according to law.*" The law allowing interest in such cases as this is Section 14(a) of the Revenue Act, which provides that there shall be paid on delinquent taxes "*interest at the rate of 1 per centum per month upon said tax from the time same becomes due.*"

It is also to be noted that in thus providing for interest Section 14(a) is so framed as to recognize the distinction which Section 57–j makes between penalties and interest. It provides that "to any sum or sums due and unpaid * * * there shall be added the sum of five per centum on the amount of tax unpaid and *interest at the rate,*" etc.

The word "interest" is clearly used here in contradistinction to the 5 per centum which manifestly belongs to the category of penalties. The Treasury Department has consistently so held.

It is well established that a uniform construction of a law by the executive officers charged with its administration has great weight, if not controlling force, and the courts in construing it will accept that construction as the proper one unless it is manifestly

contrary to the letter or spirit of the law. *Pennoyer* v. *McConnaughty*, 140 U. S. 1.

The distinction between "penalty" and "interest" is also recognized by the revenue laws of other years. Section 3184 of the Revised Statutes specifically denominates the "5 per centum additional" as a "*penalty*" and imposes in addition thereto "*interest* at the rate of 1 per centum per month." Section 903 of the Revenue Act of 1918 (40 Stat. chap. 18, p. 1057) differs only slightly and provides that "there shall be added as a part of the tax a *penalty* of 5 per centum, together with *interest* at the rate of 1 per centum for each full month."

Interest is the compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention. *Brown* v. *Hiatts*, 15 Wall. 177. *Interest* is distinguished from *penalty*, which is a sum of money the law exacts payment of by way of *punishment*. *Sparks* v. *Lowndes County*, 98 Ga. 284; *New Whatcom* v. *Roeder*, 22 Wash. 570. Penalty is synonymous with punishment. *United States* v. *Reisinger*, 128 U. S. 398.

Notwithstanding this fundamental distinction and despite the fact that the statute provides for interest *eo nomine*, in contradistinction to a penalty, the court in the case at bar disallowed such interest on the ground that it was a penalty.

By Section 14 (a) Congress clearly intended to do two distinct things: First, to penalize the failure to pay the tax when due, and, second, to recompense

the Government not only for the forbearance of the amount of the tax during the period of delinquency but also for the actual damages sustained by the Government by reason of the expense incident to the collection of such delinquent tax. The provision for a specific penalty of 5 per centum, followed immediately by the provision for "interest at 1 per centum per month" precludes any other construction than that Congress intended to and did use the word "interest" in the sense in which that word is commonly used and understood, and intended that the 1 per centum per month should be paid solely as interest. Calculation of the latter at a rate per cent per month further evidences the intention of Congress to charge such rate as interest.

Revenue laws are to be so construed as to carry out the intention of the legislature in passing them. *United States* v. *Stowell*, 133 U. S. 1. The intention must be found from the language used. *Merritt* v. *Welsh*, 104 U. S. 694. The word "interest" is to be understood in its ordinary sense. *United States* v. *Isham*, 17 Wall 496. To hold that Congress intended to use the word in the sense of a penalty is contrary to all rules of interpretation and invokes a special definition of the word "interest" that is unwarranted.

In the case of *United States* v. *Guest* (C. C. A. 4th Cir.), 143 Fed. 456, the question presented was whether the rate of 1 per centum per month as claimed under Section 3184 R. S. was in the nature

of a penalty, and therefore barred by the statute of limitations (Section 1047 R. S.), or whether it was intended as interest *eo nomine*, and therefore collectible as a part of the tax. The Court held that "*this is recoverable as interest, and is not a penalty; there being a 5 per cent penalty specifically prescribed on the amount of the tax.*" This case is directly in point with the case at bar.

Moreover, in *Chattanooga* v. *Hill*, 139 Fed. 600, the Court says:

> The bankrupt might have paid all taxes immediately prior to the filing of a petition by or against him. This would not have been a preference. *The law means that the trustee shall do what the bankrupt might have done* and what good citizenship requires him to do.

The taxpayer (bankrupt), of course, would have been required to pay interest at 1 per centum per month in the case at bar if bankruptcy had not intervened. This principle was applied directly to the question of interest in the case of *In re Kallak*, 147 Fed. 276, where the court said:

> * * * no sound reason can be advanced why revenue laws fixing the penalty and *interest* for delinquent taxes should not be given full effect in the case of taxes legally levied and assessed prior to the adjudication. * * * Whatever would be owing by the bankrupt at the time the payment is made if no bankruptcy had intervened, that the court should require the trustee to pay. It includes the original tax and all other sums accrued thereon

> under the revenue laws of the state up to the time the payment is actually made or tendered.

To the same effect is the case of *In re Scheidt Bros.* 177 Fed. 599, where the court held that under the Ohio statutes a penalty takes the place of interest and allowed 15 per centum penalty. The statute involved in the *Scheidt case* provided for a 10 per centum penalty on delinquent taxes, and, if it becomes necessary to collect the tax by distraint or court proceedings, a further penalty of 5 per centum. *Bridge Co.* v. *Mayer*, 31 Ohio State, 317. In the *Scheidt case* the court said that the allowance of a penalty is intended to cover and is treated as interest and collectible as a part of the tax.

The court below cites one case contra, the case of *In re Ashland Emery & Corundum Company*, 229 Fed. 829. This case holds that in the case of the State tax there under consideration, interest at the rate of 1 per centum per month is a penalty, and allows only 6 per centum per year interest.

The Government contends that this case is not applicable, first, because it refers to a State statute, and, second, because the tax in that case did not become due until after the adjudication in bankruptcy, the court laying special emphasis on that fact, whereas in the present case the tax accrued and by Section 14 (a) the Government's right to interest became fixed before the intervention of bankruptcy.

Nor is the case of *New York* v. *Jersawit*, 263 U. S. 493, decisive of the question presented in the case at bar. That case involved the construction of a statute of the State of New York which provided for payment on delinquent taxes of "10 per cent of such amount, plus 1 per cent for each month the tax remains unpaid." This language is distinctly different from that of the Federal Statute here considered. The wording of the New York Statute not only does not designate the 1 per cent as *interest*, but it would be difficult to construe it as interest. The decision that the 1 per cent "is added by the statute to the ten to make a single sum" is not only compelled by the peculiar wording of the statute but is in accord with the rule respecting interest on state taxes, laid down by the New York courts. In *City of Rochester* v. *Bloss*, 185 N. Y. 42, the Court of Appeals held that "Taxes, being mere statutory impositions, do not bear interest at common law. Nor do statutes providing for interest on debts, contracts, and judgments apply to taxes. Am. & Eng. Enc. of Law (2d Ed.) Vol. 27, p. 777. In Cooley on Taxation (3d Ed.) p. 19, referring to taxes, it is said, 'They do not draw interest, as do sums of money owing upon contract, but only when it is expressly given.'" The opposite rule prevails in the case of Federal taxes. In *Billings* v. *United States*, 232 U. S. 261, this Court holds that interest on Federal taxes is collectible at common law by way of damages, and in the absence of statutory provision therefor.

In re *Clark Realty Company*, 253 Fed. 938, involves neither a claim by the United States nor a State for taxes, but was a claim by the holder of tax sales certificates wherein the claimant was endeavoring to recover the rate of interest allowed by the laws of the State of Wisconsin for the redemption of property sold for taxes. The court held that the claimant was entitled to only 6 per centum per annum and based its decision upon the case of *Dayton, Trustee*, v. *Stanard, Treasurer of Pueblo County*, 241 U. S. 588.

Dayton, Trustee, etc., v. *Stanard, Treasurer of Pueblo County, Colorado*, 241 U. S. 588, did not involve a claim for taxes by the Federal Government or the State of Colorado. The controversy arose out of the sale for taxes of real property belonging to a bankrupt estate then in the course of administration in a court of bankruptcy. Because the property was in *custodia legis* at the time of sale, the court held the sales invalid and entered a decree cancelling the certificates of purchase. The Supreme Court held that the certificate holders were entitled to be reimbursed upon the cancellation of their certificates out of the general assets of the bankrupt estate and stated that, "while we are of opinion that the certificate holders were entitled to interest upon the amounts paid at the ordinary legal rate, applicable in the absence of an express contract, we think they are not entitled to the larger interest required to be paid on redemption from tax sales." This case therefore has no bearing upon the case at bar since the tax sales were void

and the purchasers were not entitled to the higher rate of interest allowable on the redemption of property sold for taxes.

The decision of the District Court for the Eastern District of Wisconsin in the *Matter of Winthers Motors Inc.* (decided August 27, 1924, unreported) is based upon the authority of the instant case and the *Jersawit case, supra*. The argument here made therefore applies with equal force to that case.

Since the United States is entitled to interest on delinquent taxes even in the absence of statute, it being allowed as damages for withholding payment of money due, *Billings* v. *United States, supra, a fortiore,* Congress may, by enactment, fix the rate of interest. Having expressly done so in Section 14(a) of the Revenue Act of 1916, the courts must give that rate effect.

II

Interest at the rate of 1 per centum per month provided by Congress is not excessive

The Government might well rest its case here were it not for the fact that the court below held interest at the rate of 1 per centum per month to be so excessive as to constitute a penalty notwithstanding the express contrary intention of Congress.

Interest at 1 per centum per month is not unusual nor is it considered excessive in commercial transactions. The legislatures of the several States have provided legal interest on simple contracts between individuals at rates ranging from 5 to 10 per centum

per year. On written contracts rates are provided at from 6 to 12 per centum, and higher in certain instances. In a majority of the Western States the legal rate of interest is 8 per centum and the maximum contract rate is 12 per centum. (Appendix.)

Under Section 63(a) of the Bankruptcy Act, the courts frequently allow claims against bankrupts on their written contracts carrying the maximum contract rates of interest, *In Re Hawks*, 204 Fed. 309 at p. 315, which in some instances may be higher than 12 per centum per annum. The duty of paying taxes is a high obligation of citizenship. For the courts to allow interest at the rate of 12 per centum on the claims of private creditors and not on claims for taxes due the Government is to subordinate a public duty to a private right. Certainly a discrimination so unjust and so contrary to public policy was never intended by Congress.

The Government is entitled to be made whole and recompensed both for the forbearance of the tax during the period of delinquency and the expense to which it is put as a result of such delinquency.

Failure to pay a tax when due automatically sets in motion various arms of the Government for the purpose of collecting the delinquent tax which would not otherwise be called into operation. This machinery is necessary for the proper support of the Government, and when set in motion for the collection of a particular delinquent tax the expense involved should be borne by the delinquent taxpayer.

In its endeavor to relieve other taxpayers of the burden of such increased cost of collection and to place it upon the delinquent taxpayer, where it properly belongs, Congress has provided a rate of interest calculated to reimburse the Government both for the forbearance and damages.

Therefore, unless the rate prescribed is beyond all reason, the intention of Congress should prevail.

The damage sustained by the Government in a particular case is extremely difficult, if not impossible, of determination. The cost of collection of delinquent taxes in the aggregate, however, is estimated with a greater degree of accuracy. Congress has provided a rate of interest to be paid on such delinquent taxes which approximately covers the expense to which the Government is put. The Commissioner of Internal Revenue reports that fully 1 per cent per month is required to meet this expense and compensation for forbearance of the tax during the period of delinquency.

In the absence of statute, interest is allowed as damages, and this court in the case of *Loudon* v. *Taxing District*, 104 U. S. 771, 774, stated that—

> All damages for delay in the payment of money owing upon contract are provided for in the allowance of interest, which is in the nature of damages for withholding money that is due. The law assumes that interest is the measure of all such damages.

It is submitted therefore that in establishing a rate of interest at 1 per centum per month on delinquent

taxes Congress took into consideration not only the forbearance of the money during the period of delinquency but likewise the actual damages sustained by the Government due to the cost of collecting such taxes.

Congress having provided a rate of interest to be paid on delinquent Federal taxes and its intention being clear that the amount is to be paid as interest and not as a penalty, the rate named by Congress should be sustained.

III

The rate of interest provided by State law is not applicable to delinquent Federal taxes owing by bankrupts

While the lower court declined to allow the rate of interest provided in Section 14(a) of the Revenue Act, it did allow interest on the Government's claim for taxes at the rate prescribed in the general interest statute of the State of New York.

A general interest law of a state is not applicable under any circumstances even to state taxes, let alone Federal taxes. *People* v. *Central Pacific R. Co.*, 105 Cal. 576; *City of Rochester* v. *Bloss*, *supra*. To use such statute as the criterion by which to measure the interest to be allowed on Federal taxes is to apply the statute directly. It is well established this may not be done.

In *Boston & Maine R. Co.* v. *United States*, 265 Fed. 578; certiorari denied, 255 U. S. 577, it is said:

> Under the logic of the fundamental and salutory rule of uniformity unless a contrary

> intention clearly appears, statutes creating a system under which taxes are to be laid are generally, if not always, accepted as intending a system to work uniformly throughout the domain in which the law is to operate. *Hence it follows that the argument that the force of an express provision of a Federal statute should be controlled or abridged by a local state statute is wholly inadmissible.*

It is the duty of the courts to enforce the provisions of the federal internal-revenue laws relating to interest on delinquent taxes, and not to arbitrarily substitute a rate fixed by a state statute.

It is the province of the courts to enforce, not to make, laws; and if the law works inequitably the redress, if any, must be had from Congress, and arguments directed not to the construction of the act, but as to the justice of the method of distribution under the bankruptcy law, and the hardship resulting therefrom, can not influence judicial determination. *New Jersey* v. *Anderson*, 203 U. S. 483.

Application of the legal rates of interest provided by the laws of the various states to delinquent federal taxes necessarily would establish a shifting rate of interest thereon, depending upon the rate in force in the particular state. It is apparent, therefore, that a single uniform rate of interest to be paid on delinquent federal taxes is not only highly desirable, but essential to a proper and efficient determination of the Government's claims for taxes in bankruptcy proceedings.

CONCLUSION

Our argument, in brief, is this: It is claimed, first, that this 1 per cent a month is, both in name and fact, interest as defined and applied by this court in *Brown* v. *Hiatts*, 15 Wall. 177, and *Billings* v. *United States*, 232 U. S. 261, being nothing more than a commensurate compensation which Congress has undertaken to provide in a particular class of cases for the forbearance of money due from the taxpayer to the Government and for the increased cost of collecting the same. In the second place, it is insisted that since this per centum is merely interest, it is allowable either under Section 64(a) of the Bankruptcy Act as part of the tax itself, *In re Scheidt Bros.*, 177 Fed. 599, or under 57–j as interest *eo nomine*.

For these reasons the judgment of the Circuit Court of Appeals should be reversed.

JAMES M. BECK,
Solicitor General.

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Assistant Attorney General.

SEWALL KEY,
Attorney.

OCTOBER, 1924.

APPENDIX

Interest laws, 1923

States and Territories	Legal rate	Rate allowed by contract	States and Territories	Legal rate	Rate allowed by contract
	Per cent	*Per cent*		*Per cent*	*Per cent*
Alabama	8	8	Montana	8	10
Alaska	8	12	Nebraska	7	10
Arkansas	6–10	0–10	Nevada	7	7
Arizona	6	10	New Hampshire	6	[2] 6
California	7	12	New Jersey	6	6
Colorado	8	12	New Mexico	10	12
Connecticut	6	6	New York	6	[2] 6
Delaware	6	6	North Carolina	6	6
District of Columbia	6	8	North Dakota	6	10
Florida	8	10	Ohio	6	8
Georgia	7	8	Oklahoma	6	10
Hawaii	8	12	Oregon	6	10
Idaho	7	10	Pennsylvania	6	6
Illinois	5	7	Porto Rico	6	[4] 12
Indiana	6	8	Rhode Island	[3] 6	[1]
Iowa	6	8	South Carolina	7	8
Kansas	6	10	South Dakota	7	12
Kentucky	6	6	Tennessee	6	6
Louisiana	5	8	Texas	6	10
Maine	6	12	Utah	8	12
Maryland	6	6	Vermont	6	[5]
Massachusetts	6	[1]	Virginia	6	6
Michigan	5	7	Washington	6	12
Minnesota	6	10	West Virginia	6	6
Mississippi	6	8	Wisconsin	6	10
Missouri	6	8	Wyoming	8	12

[1] Any rate.
[2] Unless a different rate is expressly stipulated.
[3] New York has legalized any rate of interest on call loans of $5,000 or upward on collateral security.
[4] Pawnbrokers, 4 per cent per month.
[5] No statute.

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In the Supreme Court of the United States.

OCTOBER TERM, 1922.

UNITED STATES OF AMERICA, PETITIONER,
v.
EDWARDS H. CHILDS, TRUSTEE IN BANKRUPTCY of J. Menist Company (Inc.). } No. —.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

The Solicitor General of the United States of America prays for a writ of certiorari to review the decision and judgment of the United States Circuit Court of Appeals for the Second Circuit entered April 16, 1923, which decision and judgment affirmed the order in bankruptcy of the District Court of the Southern District of New York disallowing interest at the rate of 12 per cent a year on a claim of the United States for taxes and allowing interest at the rate of only 6 per cent a year.

STATEMENT OF THE CASE.

On September 30, 1919, the United States assessed against the corporate income of J. Menist Company, Incorporated, an additional tax of $2,421.75 for the

taxable year 1917, and demanded that the same be paid on or before December 11, 1919. No payment was made, and the corporation was adjudged bankrupt on April 6, 1920.

On May 5, 1921, the United States, through the Collector of Internal Revenue for the Second Collection District of New York, filed a claim in the bankruptcy court for the said tax plus 5 per cent penalty and 1 per cent per month interest until paid. Under the provisions of Section 57 (j) of the Bankruptcy Act the United States withdrew its claim for the penalty of 5 per cent, but insisted that interest at the rate of 1 per cent per month from ten days after due notice and demand for the payment of the tax should be allowed.

The District Court held that interest at the rate of 1 per cent per month was a penalty, and therefore declined to allow interest at the rate of 1 per cent per month, but did allow the claim for the tax with interest at the rate of 6 per cent per year. Affirmance of this order by the Circuit Court of Appeals is the occasion of the present petition.

That the tax was duly levied and is correct in amount are matters not in controversy.

QUESTION INVOLVED.

Is interest at the rate of 1 per cent per month, as provided by the Federal Internal Revenue laws, collectible after due notice and demand from the estate of a bankrupt?

STATUTES INVOLVED.

The Act of October 3, 1917 (40 Stat. 300, Sec. 212), making Sec. 14 (a) of the Act of September 8, 1916 (39 Stat. 756), applicable to taxes under the Act of 1917, provides that:

> * * * to any sum or sums due and unpaid after the fifteenth day of June of any year, or after one hundred and five days from the date from which the return of income is required to be made by the taxpayer, and after ten days notice and demand thereof by the Collector, there shall be added the sum of five per centum on the amount of tax unpaid *and interest at the rate of one per centum per month upon said tax from the time the same becomes due.*

Section 57 (j) of the Bankruptcy Laws of the United States provides that:

> Debts owing to the United States, a State, a county, a district, or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby *and such interest as may have accrued thereon according to law.* (Italics ours.)

REASONS FOR GRANTING THE PETITION.

1. The Circuit Court of Appeals erred in holding that interest at the rate of 1 per cent a month provided by the Federal Internal Revenue laws is a

penalty, and in disallowing the claim of the United States for interest at the rate of 1 per cent a month.

2. The opinion of the Circuit Court of Appeals for the Second Circuit is in conflict with the opinion of the Circuit Court of Appeals for the Fourth Circuit in the case of *United States* v. *Guest*, 143 Fed. 456 and 458, and the opinions in the cases of *In re Kallak*, 147 Fed. 276 (D. C. D. No. Dak.); *In re Scheidt Brothers*, 177 Fed. 559 (D. C. S. D. Ohio).

3. The question of the rate of interest to be allowed the Government for taxes due from the estates of bankrupts is of great public importance in that many thousands of such cases are pending in the Federal Courts throughout the United States; in many such cases interest at the rate of 1 per cent per month has been allowed, and in others interest at different and varying rates has been allowed.

4. The conflict between the decision of the Circuit Court of Appeals for the Second Circuit and the decisions in the other Circuits results in a confusion which makes it necessary that the question involved should finally be determined by this Court in order to establish uniformity in the administration of the Bankruptcy Law throughout the United States.

BRIEF IN SUPPORT OF PETITION.

The decision of the Circuit Court of Appeals for the Second Circuit results in a lack of uniform application and administration of the bankruptcy laws. Congress has provided and established a uniform rate of interest on Federal taxes applicable to all tax-

payers for delinquency after due notice and demand. Congress has seen fit to establish that rate at 1 per cent per month. The decision of the Circuit Court of Appeals for the Second Circuit fixes a rate of 6 per cent as collectible from the estate of bankrupts and holds that interest beyond that rate is a penalty. While the rate of interest fixed by Congress is of uniform application throughout the United States, the decision of the Circuit Court necessarily establishes a shifting rate of interest depending upon the legal rate in force in the particular state. In New York it is 6 per cent, while in the Middle West the usual statutory rate is 8 per cent and on the Pacific Coast 10 per cent. Under the rule laid down by the Circuit Court there is no uniformity in the interest rate to be paid by the estates of bankrupts, whereas under the Federal Act uniformity in all cases is attained.

The correctness of the assessment of the tax in this case is not in question. The question is whether interest at the rate of 1 per cent a month, provided by the taxing statutes, is a penalty, and not allowable as such under Section 57 (j) of the Bankruptcy Act.

Interest is recoverable under Section 3184, R. S., providing for the collection of delinquent internal-revenue taxes with interest at the rate of 1 per cent per month and is not a penalty but recoverable as interest. *United States* v. *Guest* (C. C. A. 4th Cir.), 143 Fed. 456, 458.

In the case of *In re Scheidt Brothers* (D. C. S. D. Ohio), 177 Fed. 559, the court held that a penalty takes the place of interest and allowed 15 per cent

penalty under the Ohio State statutes. The statute involved in the *Scheidt case* provides for a 10 per cent penalty on delinquent taxes, and if it becomes necessary to collect the tax by distraint or court proceedings a further penalty of 5 per cent. *Bridge Company* v. *Mayer*, 31 Ohio State, 317, 328. In the *Scheidt case* the court said that the allowance of a penalty is intended to cover and is treated as interest and collectible as a part of the tax.

In the case of *Ashland Emery & Corundum Company*, 229 Fed. 829, the court held that interest on taxes not paid when due becomes a part of the taxes and entitled to priority of payment under the Bankruptcy Act. The court allowed interest only at the rate of 6 per cent per annum, however, holding that 1 per cent per month was not interest but a penalty.

In the case of *New Jersey* v. *Anderson*, 203 U. S. 483, this court stated that it is the province of the courts to enforce, not to make, laws; and if a law works inequitably the redress, if any, must be had from Congress, and arguments directed not to the construction of the Act, but as to the justice of a method of distribution of assets under the bankruptcy law, and the hardship resulting therefrom, can not influence judicial determination.

The question involved in this case is of great public importance. If the rate of interest on bankruptcy claims is limited to 6 per cent per annum, as held by the Circuit Court of Appeals for the Second Circuit in this case, the United States will be deprived of its apparent right to collect interest at the rate of 1

per cent per month and may be compelled to refund large sums of money already collected as interest at the higher rate prescribed by Congress in the taxing act.

It is submitted that in the case of claims for Federal taxes filed with a bankruptcy court the rate of "such interest as may have accrued thereon according to law," within the meaning of Section 57 (j) of the Bankruptcy Act, is 1 per cent a month.

A number of cases involving this same question are pending in the District Courts of the United States and are being held in abeyance pending the final determination of this case. A decision of the question involved in this case is necessary to the establishment of a uniform system of administering the bankruptcy laws and the collection of taxes from the estates of bankrupts.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari to review the decree of the Circuit Court of Appeals for the Second Circuit be granted.

JAMES M. BECK,
Solicitor General.

JUNE, 1923.

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No. 347 80

IN THE

Supreme Court of the United States

OCTOBER TERM, 1923

UNITED STATES OF AMERICA,
Petitioner,

—vs.—

EDWARDS H. CHILDS, Trustee in Bankruptcy of J. MENIST COMPANY (Inc.),
Respondent.

BRIEF OF RESPONDENT IN OPPOSITION TO APPLICATION FOR WRIT OF CERTIORARI.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1922.

UNITED STATES OF AMERICA,
Petitioner,

—vs.—

EDWARDS H. CHILDS, Trustee in Bankruptcy of J. MENIST COMPANY (Inc.),
Respondent.

RESPONDENT'S BRIEF.

POINT I.

THE COURT BELOW PROPERLY HELD THAT A CLAIM FOR INTEREST AT THE RATE OF ONE PER CENT. PER MONTH IN A BANKRUPTCY PROCEEDING IS A PENALTY AND SHOULD BE DISALLOWED.

Section 57-j of the Bankruptcy Act provides as follows:

> "Debts owing to the United States, a state, a county, a district, or a municipality as a penalty or forfeiture, shall not be allowed, ex-

cept for the amount of the pecuniary loss sustained by the act, transfer or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

The District Court for the Southern District of New York and the Circuit Court of Appeals for the Second Circuit held that interest on the tax should be allowed up to the date of payment, but that interest at the rate of one per cent. (1%) per month *amounts to a penalty and must be disallowed,* under section 57-j of the Bankruptcy Act.

The United States Government contends that a writ of certiorari to review the decision and judgment of the United States Circuit Court of Appeals be granted, because of a conflict between the decision of the Circuit Court of Appeals for the *Second Circuit* and the decisions in the *other Circuits* as to the rate of interest to be allowed for the non-payment of taxes after the filing of a petition in bankruptcy.

In support of that contention the Solicitor-General relies upon the case of the *United States vs. Guest,* 143 Fed. 456, as being in variance with the decision in the case at bar. Upon a careful examination of the opinion of the Court in *re United States vs. Guest, supra,* it is clear that the decision is not in conflict with the ruling of the Circuit Court of Appeals for the Second Circuit. In that case no question as to the effect of the Bankruptcy Act upon the rate of interest for the non-payment of taxes arose. An action was brought to recover a judgment upon a certain distiller's bond executed by William A. Morgan as principal with one Tramel & Guest as sureties. The Government sought to recover the sum of $51.15 stamp tax on spirits con-

tained in a certain package removed from one of its distillery warehouses with interest thereon at the rate of one per cent. (1%) per month from the first day of October, 1896, and also for the sum of $88.12 for deficiency spirits during the months of June and July, 1896, with interest at the same rate from the 1st of February, 1897 until paid, together with a penalty of five per cent. (5%) imposed upon said two sums. The Court there held that such interest is not a penalty but is recoverable as interest.

There is, however, no conflict of authority in the Circuit Courts of Appeal as to what rate of interest on tax should be allowed under Section 57-j of the Bankruptcy Act. The only conflict is between the District Court decisions and the Circuit Courts of Appeal decisions.

Re Ashland, Emery & Corundum Co., 229 Fed. 829 Dist. Ct. of Mass.;
Re Clark Realty Co., 253 Fed. 938, Circuit Court of Appeals Seventh Circuit;
Dayton, Trustee, etc. vs. Stanard, Trustee, Pueblo County, Col. 241 U. S. 588.

In *re Ashland, Emery & Corundum Co.* (*supra*), Judge Morton, whose reasoning was followed by both the District Court for the Southern District of New York and the Circuit Court of Appeals for the Second Circuit, says on page 831:

> "If the charge here in controversy is to be regarded as interest, the trustee ought to pay it. Penalties, however, stand upon a different footing. It cannot be said that a penalty imposed for failure to pay a tax, is part of the original tax, in the sense that interest is. By 'interest' is ordinarily understood a charge for the use of money or damages for the detention of it. A

penalty, as applied to cases of this character, means a punishment imposed for failure to make the payment on time. Section 64-a contains no provision for the payment of penalties; and I do not think it can fairly be construed to include them, especially when, as here, the estate was in course of administration during the entire period when they accrued."

and again at page 832:

"Assuming, however, that it is, it seems to me plain, and I accordingly find, that 1% a month exceeds what is fairly required to make good loss to the state for mere delay in the payment of the tax, and as to such excess is not interest, but constitutes a penalty imposed for failure to pay promptly. The actual damages sustained by the State of New Jersey from the delay are not obscure nor difficult to estimate, what the state lost was the use of the money. Its damages, therefore, are the commonest form known to the law, and the most certain of estimation. They are established by statute in New Jersey for individuals at 6% per annum."

In *re Dayton vs. Stanard* (*supra*), a controversy grew out of the sale for taxes and special assessments of divers tracts of real property belonging to a bankrupt estate then in the course of administration in a Court of Bankruptcy and in construing Section 64-a of the Bankruptcy Act the Court held that the holders of tax certificates who have paid taxes and assessments on property of the bankrupt at tax sales of such property which sales have been declared invalid, are entitled to be reimbursed in the amount paid on cancellation of their certificates out of the general fund of the bankrupt's estate with legal interest *but not* with a larger interest and

penalty imposed by statutes in tax sale redemptions. The Court in this case squarely holds that penalties are not allowed under Section 64-a of the Bankruptcy Act.

The fact that the statute itself calls it interest would not be conclusive upon the Bankruptcy Court, which has the right and power as well as the duty, to examine and decide the question for itself.

The rate of interest allowed in *re Ashland, Emery & Corundum Co.* (*supra*), is probably more common than any other within the United States, and it is to be noted that under Section 6407 of the United States Compiled Statutes, if a plaintiff secures a judgment against the United States, and the Secretary of the Treasury asserts a set-off, any balance found to be payable by the United States over and above the lawful set-off bears interest at the rate of six per cent. per annum.

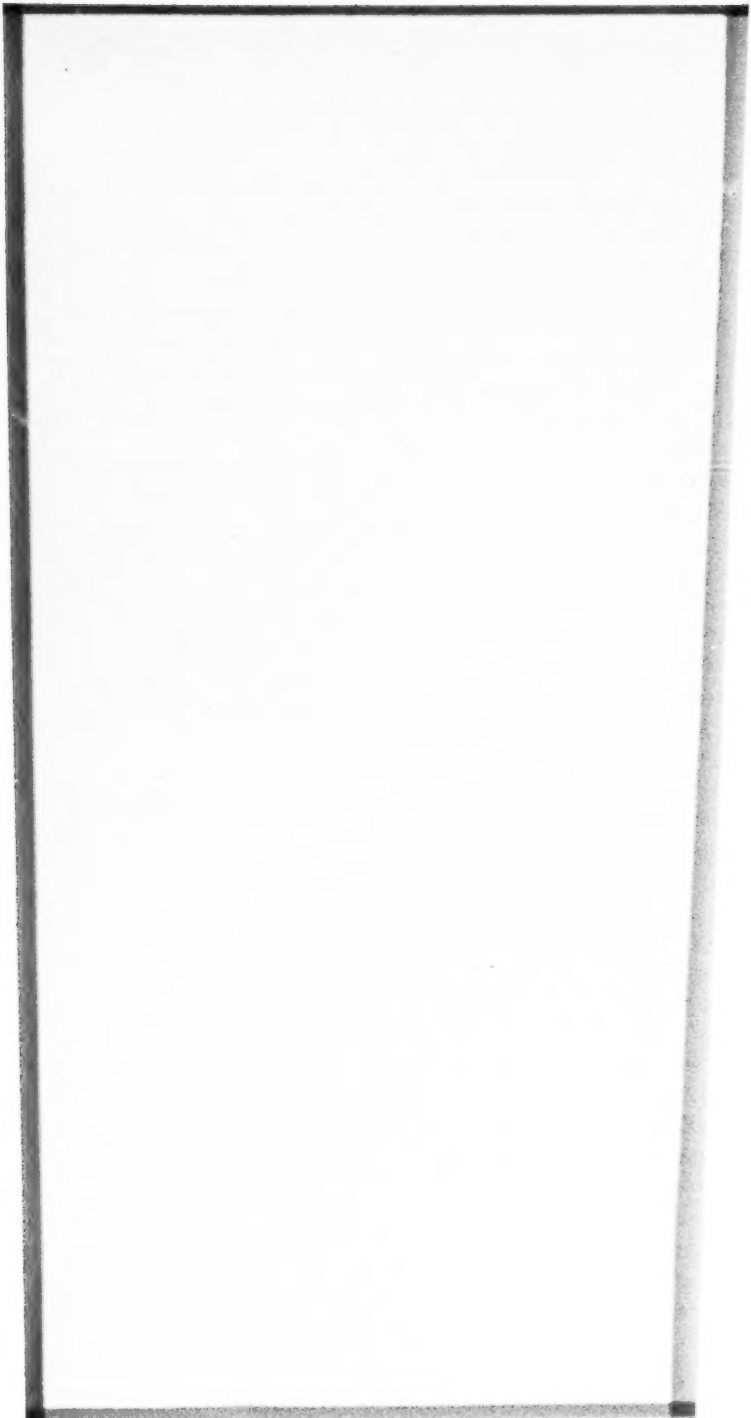
From an examination of the authorities above cited, it is evident that the question involved in this case is of no great public importance. The Circuit Court of Appeals for the Seventh Circuit is in accord with the Circuit Court of Appeals of the Second Circuit and the Seventh Circuit in *re Clarke Realty Co.* (*supra*), bases its reasoning upon the opinion of Mr. Justice Van Devanter in the case of *Dayton, Trustee vs. Stanard*, 241 U. S. 588.

POINT II.

THE APPLICATION FOR A WRIT OF CERTIORARI SHOULD BE DENIED WITH COSTS.

Respectfully submitted,

MOSES COHEN,
Of Counsel for Respondent.



UNITED STATES *v.* CHILDS, TRUSTEE IN BANKRUPTCY OF J. MENIST COMPANY, INC.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

No. 80. Submitted October 14, 1924.—Decided November 24, 1924.

In the provision of the Act of 1916 (§ 14–a, Tit. I, Part II, 39 Stat. 756) adding the sum of 5% to delinquent income tax and "interest" at the rate of 1% per month upon the tax from the time it became due, the interest is not penal but compensatory, and its allowance, on a claim by the Government against a bankrupt, is therefore consistent with § 57–j of the Bankruptcy Act. *New York* v. *Jersawit*, 263 U. S. 493, distinguished. P. 307.

290 Fed. 947, reversed.

CERTIORARI to a judgment of the Circuit Court of Appeals affirming an order of the District Court which, in turn, affirmed an order of a referee in bankruptcy allowing the Government's claim for an income tax, but fixing the interest thereon at 6% per annum, the legal rate in the State, in lieu of the 1% per month demanded by the Government.

Mr. Solicitor General Beck, Mrs. Mabel Walker Willebrandt, Assistant Attorney General, and *Mr. Sewall Key* for the United States.

The Government is entitled to interest upon its claim at the rate of one per centum per month.

While § 57–j of the Bankruptcy Act forbids the allowance of penalties against the estate of a bankrupt, it specifically allows "such interest as may have accrued

. . . according to law." The law allowing interest in such cases as this is § 14(a) of the Revenue Act.

The word "interest" is clearly used here in contradistinction to the five per centum which manifestly belongs to the category of penalties. The Treasury Department has consistently so held. The distinction between "penalty" and "interest" is also recognized by the revenue laws of other years.

The word "interest" is to be understood in its ordinary sense. *United States* v. *Isham*, 17 Wall. 496. To hold that Congress intended to use the word in the sense of a penalty is contrary to all rules of interpretation and invokes a special definition of the word "interest" that is unwarranted. *United States* v. *Guest*, 143 Fed. 456; *Chattanooga* v. *Hill*, 139 Fed. 600; *In re Kallak*, 147 Fed. 276; *In re Scheidt Bros.*, 177 Fed. 599. Distinguishing *In re Ashland, etc. Co.*, 229 Fed. 829; *New York* v. *Jersawit*, 263 U. S. 493; *Rochester* v. *Bloss*, 185 N. Y. 42; *In re Clark Realty Co.*, 253 Fed. 938; *Dayton* v. *Stanard*, 241 U. S. 588; *In re Winthers Motors, Inc.*, (D. C. E. Wis., Aug. 27, 1924, unreported).

The United States is entitled to interest on delinquent taxes even in the absence of statute. *Billings* v. *United States*, 232 U. S. 261.

Interest at the rate of one per centum per month provided by Congress is not excessive.

The rate of interest provided by state law is not applicable to delinquent federal taxes owing by bankrupts. *People* v. *Central Pac. R. R. Co.*, 106 Cal. 576; *Rochester* v. *Bloss*, 185 N. Y. 42; *Boston & Maine Railroad* v. *United States*, 265 Fed. 578; certiorari denied, 255 U. S. 577.

Mr. Moses Cohen for respondent.

The Government is not entitled to interest.

Taxes are regarded as debts under the Bankruptcy Act. *In re Sherwoods*, 210 Fed. 754; *Kaw Boiler Works* v. *Schull*, 230 Fed. 587.

The United States is bound by the Bankruptcy Act. *Guarantee Co.* v. *Title Guaranty Co.*, 224 U. S. 152; *U. S. Fidelity Co.* v. *Bray*, 225 U. S. 205; *United States* v. *Wood*, 290 Fed. 109; affd. 263 U. S. 680.

In the determination of the question as to whether federal taxes bear interest, § 63–a of the Bankruptcy Act must likewise be considered. Debts do not bear interest after the filing of the petition in bankruptcy. *Sexton* v. *Dreyfus*, 219 U. S. 339. Section 57–j of the Bankruptcy Act provides for the payment of "such interest as may have accrued thereon according to law." What other law could have been intended than the law that a debt bears interest until the date of the filing of the petition in bankruptcy? *Swarts* v. *Hammer*, 194 U. S. 441, distinguished.

If the Government is entitled to interest on its claim until paid, the rate of interest should not be more than 6 per cent. per annum. *Sun Printing Assn.* v. *Moore*, 183 U. S. 642; *In re Ashland, etc. Co.*, 229 Fed. 829; *New York* v. *Jersawit*, 263 U. S. 493; *In re Clark Realty Co.*, 253 Fed. 938; *Dayton* v. *Stanard*, 241 U. S. 588.

Mr. Justice McKenna delivered the opinion of the Court.

The Collector of Internal Revenue of the Second District of New York filed a claim against the Trustee in Bankruptcy of J. Menist Company, Inc., Edward H. Childs, in the sum of $2,421.75, plus 5% penalty and 1% interest per month thereon until paid. The claim was for an additional income tax for the year 1917.

The justification for the claim, as stated by the Circuit Court of Appeals, is: "Act of October 3, 1917 (40 Stat. 300, sec. 212), making sec. 14(a) of the act of September 8, 1916 (39 Stat. 756), applicable to taxes under the 1917 act." By § 14(a) of Title I, Part II, of the Act of 1916, it is provided that: ". . . to any sum or sums due and

unpaid after the fifteenth day of June in any year, or after one hundred and five days from the date on which the return of income is required to be made by the taxpayer, and after ten days' notice and demand thereof by the collector, there shall be added the sum of five per centum on the amount of tax unpaid and interest at the rate of one per centum per month upon said tax from the time the same becomes due."

As an element for consideration in connection with § 14(a) is § 57–j of the Bankruptcy Act. It reads as follows: "Debts owing to the United States, a State, a county, a district, or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

The Government withdrew its claim for 5% penalty but urged its claim for 1% interest.

The Referee, however, decided that the cited provisions "constitute a statutory characterization or definition . . ." not only as to the 5% penalty but also in respect to the 1% interest per month, and relieved the estate in bankruptcy from its payment. He allowed the claim for $2,421.75 with interest at 6% per anum to the date of payment.

The order was affirmed by the District Court. This was affirmed by the Circuit Court of Appeals and its action is now here for review.

At the outset we are confronted with the difference between penalty and interest. A penalty is a means of punishment; interest a means of compensation. Bouvier defines it to be "a consideration paid for the use of money or for forbearance in demanding it when due." This Court has declined to give it peremptory definition, and construing statutes considered that it could "safely de-

cline either to limit" the word debts "to existing dues, or to extend its meaning so as to embrace all dues of whatever origin and description." *Lane County* v. *Oregon*, 7 Wall. 71, 79. See also *New Jersey* v. *Anderson*, 203 U. S. 483, 493. To what conclusion does like liberty of construction conduct in the present case?

The imposition of a tax is certainly a function of government and creates an obligation, and the power that creates the obligation can assign the measure of its delinquency—the detriment of delay in payment; and § 14(a) has done so in this case, and explicitly done so. Five per centum penalty is the cost of delinquency, and interest upon the amount due at 1% per month—12% a year. There is no ambiguity in the declaration nor the distinction made. Against their clearness and completeness § 57–j of the Bankruptcy Act is cited.

The Government yields as to the 5% penalty. It resists as to the 1% interest. The Circuit Court of Appeals considered that the 1% was involved as well, as being in effect penalty and not saved by its name, though it was imposed by the legislature and within the legislative power, and notwithstanding that taxes are treated as debts within the meaning of the Bankruptcy Act. *In re Sherwoods*, 210 Fed. 754, 758; *Kaw Boiler Works* v. *Schull*, 230 Fed. 587.

The Circuit Court of Appeals adjudged the tax in the present case a debt and assigned against it interest at 6%; the court considering that that interest was compensation for the delinquency, anything in excess becoming penalty and within the prohibition of § 57–j. The court said, "On the point at bar [one per cent. interest as the price of the delay being penalty] we are in accord with *Re Ashland, etc.*, 229 Fed. 829, and hold that there being no evidence of any injury or damage to the Government by the withholding of this tax except that which flows from the nonpayment of a just debt, anything in excess of

the legal rate of interest is to be treated as a penalty and not allowed."

We are unable to concur. It makes the rate of interest that of a particular locality, differing with the locality—in New York, as said by the Government, 6%, in the middle West 8% and on the Pacific coast 10%,—and abridges or controls a federal statute by a local law or custom, and takes from it uniformity of operation. Besides, the federal statute is precise, and it is made peremptory by the distinction between "penalty" and "interest", and if it may be conceded that the use of the latter word would not save it from condemnation if it were in effect the former, it cannot be conceded that 1% per month—12% a year—gives it that illegal effect, certainly not against legislative declaration that is within the legislative power, there being no ambiguity to resolve.

To this conclusion *New York* v. *Jersawit*, 263 U. S. 493, is not antagonistic. There a statute of New York was passed on which required "every domestic corporation" to "annually pay in advance . . . an annual franchise tax" upon its net income for the year next preceding, and provided that, if the tax were not paid, the corporation should pay "in addition to the amount of such tax . . . ten per centum of such amount, plus one per centum for each month the tax . . . remains unpaid." This liability the lower federal courts pronounced a penalty and not to be allowed. In that conclusion this Court concurred and decided that, being penalty, it was disallowed by the Bankruptcy Act, § 57–j. And this not only because the one per centum was "more than the value of the use of the money" but because it was added by the statute to the 10% to make a single sum and "must be treated as part of one corpus and must fall with that."

The tax in this case is one on income; a burden imposed for the support of the Government. Interest is put upon it and so denominated, distinguished from the 5% as pen-

alty, clearly intended to compensate the delay in payment of the tax—the detriment of its non-payment, to be continued during the time of its non-payment—compensation, not punishment.

Judgment reversed.